APPENDIX A

Background

Treasury management is defined as "The management of the authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

In February 2012 The Police and Crime Commissioner adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the approval of a treasury management strategy before the start of each financial year. As a local authority the Police and Crime Commissioner for Lancashire ("the Commissioner") is also bound by the treasury management framework expressed within the code and therefore the requirements of the code must be met by Police and Crime Commissioners.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires Authorities, including police and crime Commissioners, to approve an investment strategy before the start of each financial year.

Statutory requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Commissioner to "have regard to" the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Commissioner's capital investment plans are affordable, prudent and sustainable.

This report fulfils the Commissioner's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

CIPFA requirements

The primary requirements of the CIPFA Code are as follows-

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Commissioner's treasury management activities, the current version is shown at Appendix 1.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Commissioner will seek to achieve those policies and objectives.

3. The production of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Commissioner of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Treasury Management Strategy for 2015/16

This Strategy Statement has been prepared in accordance with the Code of Practice (2011). In accordance with the code, the Treasury Management Strategy will be approved by the Commissioner before the start of the financial year. In addition to this the Commissioner will also receive a mid-year report and a final year-end outturn report. In addition there will be monitoring and review reports provided in the event of any changes to Treasury Management policies or practices. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The following reporting arrangements will be adopted in accordance with the requirements of the revised Code: -

Area of Responsibility	Committee/ Officer	Frequency
Treasury Management Policy Statement	Police and Crime Commissioner	Annually before the start of the financial year.
Treasury Management Strategy / Annual Investment Strategy / MRP policy – scrutiny and approval	Police and Crime Commissioner	Annually before the start of the financial year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report, scrutiny of performance	Police and Crime Commissioner	Mid year – 6 months
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Police and Crime Commissioner	As required
Annual Treasury Management Outturn Report	Police and Crime Commissioner	Annually by 30 September
Treasury Management Monitoring Reports	Chief Finance Officer	Quarterly
Treasury Management Practices	Chief Finance Officer	Annually

In setting the Treasury Management Strategy, the following factors have been taken into account; economic forecasts, the level of the approved Capital Programme and the current structure of the Commissioner's debt portfolio. It covers the following aspects of the Treasury Management function:-

- Prudential Indicators which will provide a controlling framework for treasury management activities.
- Long-term debt outstanding;
- Prospects for interest rates;
- The Borrowing Strategy;
- The Investment Strategy;
- Policy on borrowing in advance of need.

Economic Context

There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.
The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings August 2014 onwards, some Committee members have become more concerned that the economic outlook is less optimistic than at the time of the August Inflation Report.

Credit outlook

The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The Bank Recovery and Resolution Directive promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast Deposit Guarantee Schemes Directive includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations as the only senior creditors likely to incur losses in a failing bank after July 2015.

Current Treasury Portfolio Position

The current estimate of the Commissioner's Treasury Portfolio at the beginning of the financial year 2015/16 is:	**Principal £000**	**%**
DEBT		
Fixed rate loans from PWLB	19,154	100
Variable rate loans	0	0
Total debt	**19,154**	
INVESTMENTS		
Variable rate investments in the County Council's General County Fund estimated for 31/3/2015 @ 0.7%	20,000	
3 yr Fixed Loan to UK local authority matures 23/10/17 @ 1.50%	5,000	
Total investments	**25,000**	

The level of investments represents the Commissioner's cumulative surplus on the General Fund, the balances on other cash-backed earmarked reserves and a cash-flow balance generated by a surplus of creditors over debtors and by grant receipts in advance of payments. There is net surplus position of £5.846m estimated at the end of financial year 2014-15.

Borrowing Requirement, Strategy and Prospects for Interest Rates.

The table below shows the total borrowing requirement for the current and the next three years.

The Commissioner has not borrowed for capital purposes since 2007, preferring instead to fund capital expenditure and maturing borrowing from internal resources.

The total amount of this 'internal borrowing' is represented by the borrowing requirement which is being carried forward each year. In the past the assumption has always been made that maturing borrowing, when not replaced in year, would be carried forward as a future borrowing requirement. In addition the unused borrowing requirements of previous capital programmes were carried forward on the assumption that project timescales had slipped, and the borrowing would still be required at some future point and this resulted in a borrowing requirement brought forward the end of 2013/14 of £17.954m.

It is felt that the brought forward borrowing figure is no longer required in the new environment and that it is very unlikely any past maturing borrowing will now need to be replaced in the near future. Accordingly this carry forward borrowing figure has now been removed from the borrowing requirement calculations from '2014/15 revised' onwards.

If it is considered appropriate to take out loans in the future to replace the internal cash that has been used to finance past capital expenditure then this is permissible under the regulations of

the Prudential Code and would need to be considered as part of the Treasury Management strategy.

	2014/15 Revised £000	2015/16 £000	2016/17 £000	2017/18 £000
Capital Programme Expenditure	**10,418**	**22,285**	**26,360**	**12,230**
Financed by:				
Capital Receipts	5,059	2,942	1,008	1,350
Grants and Contributions	2,895	3,222	2,164	2,100
Revenue Contributions	2,313	9,296	8,726	6,280
Borrowing	**151**	**6,825**	**14,462**	**2,500**
Add Maturing Debt to be replaced:				
Long Term PWLB	1,000	1,000	500	1,100
Previous Year Borrowing Requirement brought forward	-			
Less Statutory Charge to Revenue	(1,326)	(1,288)	(1,300)	(1,304)
Total Borrowing Requirement	**(175)**	**6,537**	**13,662**	**2,296**

Capital Funding Strategy

The Commissioner has set aside funding in ear-marked revenue reserves to contribute to the delivery of the investment included in the Capital Programme. This resource will be used, in the first instance, to provide finance for short life assets such as IT systems and equipment in order to avoid the use of borrowing where possible for this type of asset. This approach represents a prudent strategy for the funding of short life assets as the cost of borrowing over shorter terms is more expensive than for longer periods and the use of reserves to minimise such shorter life borrowing represents better value for money.

Interest Rate Forecast and Prospects for Market Liquidity

The prevailing and forecast interest rate situation will be monitored to ensure that opportunities for debt restructuring are maximised. Regular forecasts of interest rates are provided by Arlingclose Ltd, treasury management advisers to Lancashire County Council.

Treasury Consultants Arlingclose Ltd forecast the first rise for official interest rates to be in September 2015 with a gradual pace of increases thereafter and the average bank rate for

2015/16 being around 0.75%. Arlingclose are also forecasting that when the economy reaches the point that it can be considered to have recovered from the financial crisis, and rates rise to 'normal' levels, bank rate will range between 2.5% and 3.5%, considerably lower than pre-crisis levels. Arlingclose also consider that the risk interest rates will be higher than this forecast increases as the forecast looks further into the future beyond 2016. On the downside, the chance that interest rates will be lower than the forecast, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year and so this risk is higher at the near end of the forecast.

Arlingclose expect the deteriorating Eurozone situation will result in gilt yields will remain low in the short term but still on an upward path through the medium term.

The latest forecast provided by Arlingclose Ltd is shown in the table below:

	Bank Rate	3 Month LIBID	12 Month LIBID	5 year Gilt Yield	10 year Gilt Yield	25 year Gilt Yield	50 year Gilt Yield
Mar 15	0.50	0.60	1.00	1.45	2.00	2.55	2.65
Jun 15	0.50	0.75	1.05	1.60	2.10	2.65	2.70
Sep 15	0.75	0.90	1.20	1.75	2.20	2.75	2.80
Dec 15	0.75	1.05	1.35	1.90	2.30	2.85	2.90
Mar 16	1.00	1.20	1.50	2.00	2.40	2.95	3.00
Jun 16	1.00	1.35	1.65	2.15	2.50	3.00	3.05
Sep 16	1.25	1.50	1.80	2.25	2.60	3.05	3.10
Dec 16	1.25	1.60	1.95	2.35	2.70	3.10	3.15
Mar 17	1.50	1.70	2.10	2.45	2.75	3.15	3.20
Jun 17	1.50	1.80	2.20	2.50	2.80	3.20	3.25
Sep 17	1.75	1.90	2.30	2.55	2.85	3.25	3.30
Dec 17	1.75	2.00	2.40	2.60	2.90	3.30	3.55
Mar 18	1.75	2.10	2.50	2.60	2.95	3.30	3.60

In the above table 'bank rate' refers to the policy rate of the Bank of England. 'LIBID' is the London Interbank bid rate and can be used as a proxy for short term market interest rates. PWLB borrowing rates are based on 'Gilt Yield' and so this is a forecast of long term interest rates. The Commissioner can borrow at 80 basis points above the gilt yield, so for example the current fixed interest rate to borrow PWLB money for 10 years would be 2.80%, 2.00% plus 0.80%.

This forecast has been based on the following underlying assumptions:-

- The UK economic recovery has continued. Household consumption remains a significant driver, but there are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP in 2015.

- Inflationary pressure is currently low (annual CPI is currently 1.3%) and is likely to remain so in the short-term. Despite a correction in the appreciation of sterling against the US dollar,

imported inflation remains limited. We expect commodity prices will remain subdued given the weak outlook for global growth.

• Nominal earnings growth remains weak and below inflation, despite large falls in unemployment. This is likely to be because the levels of part-time, self-employment and underemployment are significant and indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.

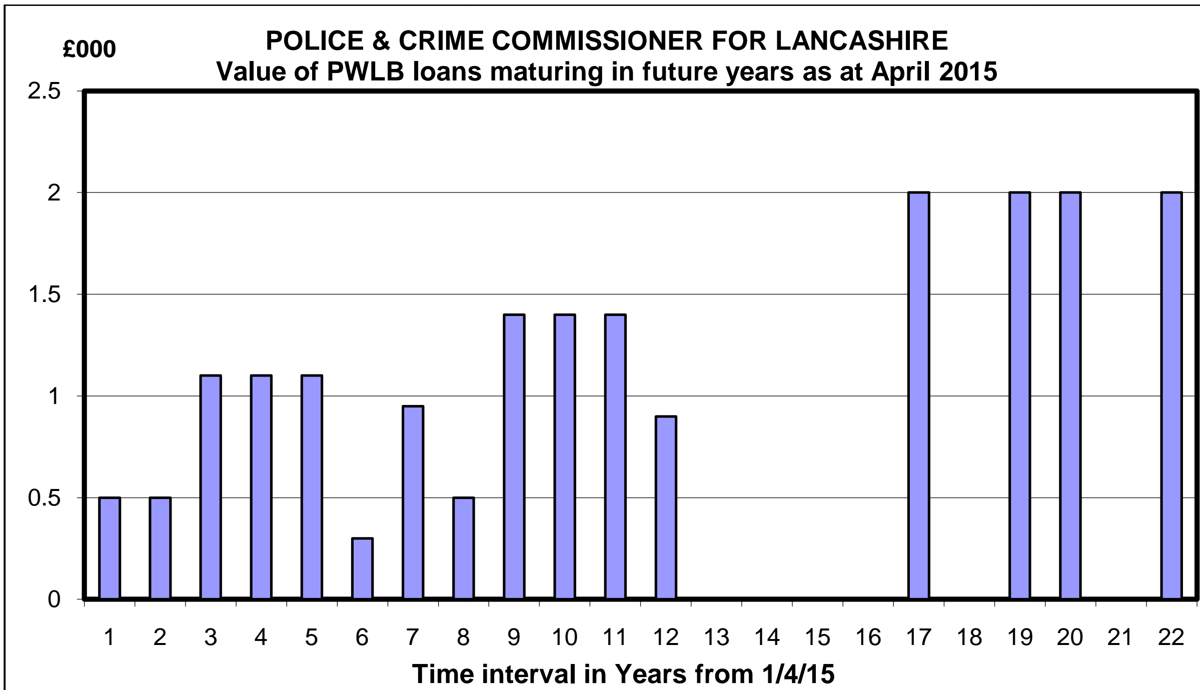
• Employment growth is expected to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure .In addition policymakers are evidently concerned about the bleak prospects for the Eurozone, and the generally subdued global environment suggests there is little prospect of significant contribution from external demand. These factors will maintain the dovish stance of the MPC in the medium term.

Borrowing Strategy

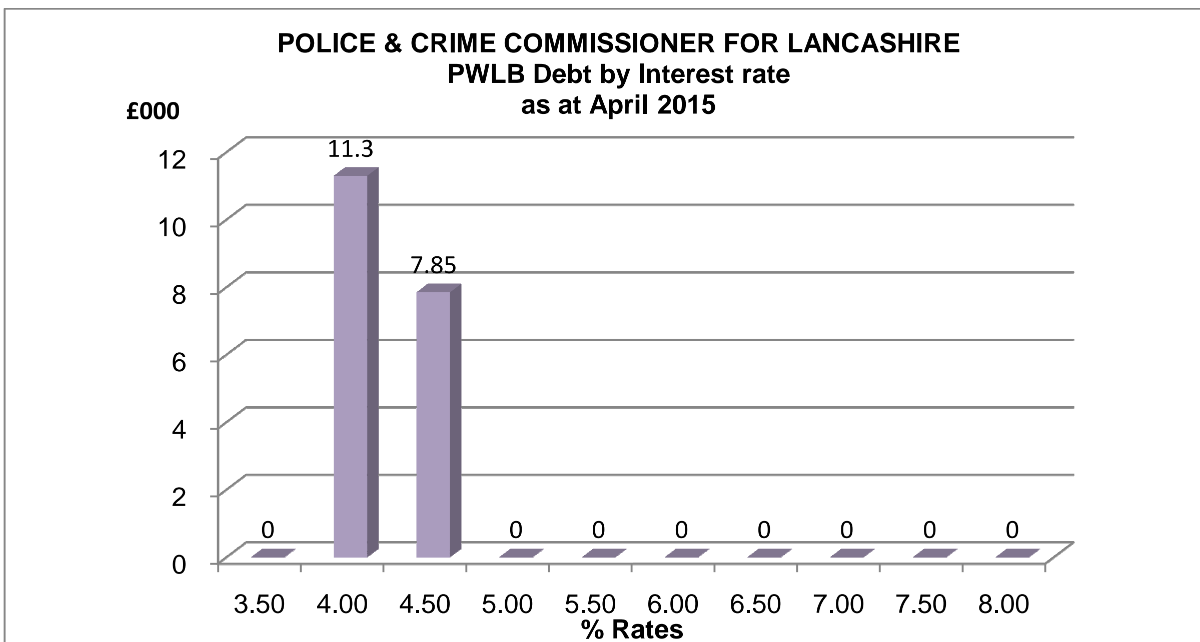
In view of the above interest rate forecast the Commissioner's borrowing strategy will be based upon the following information:-

- The UK remains in a gradually recovering but still relatively slow growth situation and with a tight fiscal and loose monetary policy approach it could be 2017 before official UK interest rates rise. Gilt yields are projected to be flat in the short term but on an upward path through the medium term.
- If it were felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- If it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

The chart below shows the current maturity profile of the Commissioner's borrowings.



The chart below shows the same borrowings analysed by interest rate.



The cheapest borrowing at present is internal borrowing facilitated by running down cash balances and foregoing interest earned on investments at historically low rates - this is the policy the Commissioner has been pursuing for a number of years, funding capital expenditure and paying down debt maturities from existing balances. The immediate future is likely to see a continuation of this policy.

However, whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. In addition the Commissioner may borrow short term loans to cover unexpected cash flow shortages.

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board
- UK local authorities
- any institution approved for investments
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds

In the past the Commissioner has raised all long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

The Chief Finance Officer, together with the County Council's treasury management team reviews options for debt restructuring on a regular basis. A recent review found that given the relatively favourable interest rates at which these have been taken out (below 5%) and the penalties associated with any early repayment, restructure is not considered financially viable at the present time. A better option for the immediate future is to utilise reserves to reduce the future borrowing requirement rather than repay debt.

Frequent discussions will continue to take place between the Chief Finance Officer and the Treasury Management Team to monitor this situation and any future decisions on debt financing will be put through the same rigorous cost and prudence analysis that external borrowing has traditionally gone through and will be reported to the Commissioner in due course.

Policy on Borrowing in Advance of Need

The Commissioner will not borrow more than or in advance of need purely in order to profit from the investment of the extra sums borrowed. However advance borrowing may be taken if it is considered that current rates are more favourable than future rates and that this advantage outweighs the cost of carrying advance borrowing. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Commissioner can ensure the security of such funds and relationships.

In determining whether borrowing will be undertaken in advance of need the Commissioner will:-

- Ensure that there is a clear link between the capital programme and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

- Consider the merits and demerits of alternative forms of funding.
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

Investment Strategy

The Commissioner will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Guidance Notes ("the CIPFA TM Code"). The Commissioner's investment priorities are: -

(a) The security of capital and
(b) The liquidity of its investments.

The Commissioner will also aim to achieve the optimum return on his investments commensurate with proper levels of security and liquidity. The risk appetite of the Commissioner is low in order to give priority to security of its investments and in accordance with this the 2015/16 policy needs to take into account the recent developments in banking reform legislation.

Banking Reform Legislation

In the past governments had only two options to resolve failing banks: insolvency, that is ceasing essential services immediately with a strong possibility of financial instability, or alternatively to conduct a taxpayer funded bail-out, either by buying new shares in the bank, or by subsidising a takeover. However recent banking reform legislation introduces a third option, which allows customers to retain access to their bank accounts, but passes the banks losses onto its investors instead of taxpayers.

The first piece of legislation concerned with the concept of 'bail-in' was the Financial Service (Banking Reform) Act 2013. This introduced bail-in as a tool for banking regulators to recapitalise failing banks by applying a 'haircut', (a percentage reduction in the amount to be paid) to investors.
A bail-in can be conducted before a bank becomes insolvent, and importantly, 7 day interbank loans, covered bonds, repurchase agreements and derivatives are exempt from bail-in. Insured deposits are classed as a preferred creditor, ranking above others in the event of insolvency.
This was followed by the Bank Recovery and Resolution Directive 2014/59/EU which in addition to the above added that large deposits (over £85,000 or €100,000) from otherwise insurable depositors (individuals and SMEs) are to rank above other uninsured deposits in both insolvency and bail-in situations. This was incorporated into UK law with effect from 1st January 2015.

Finally the Deposit Guarantee Schemes Directive 2014/49/EU will be implemented in the UK by 3rd July 2015, whereby deposit insurance schemes (e.g. FSCS) are to be extended to include large companies and charities, so that by July all non-financial private sector organisations will be eligible for compensation, however public sector and financial organisations, including pension funds and money market funds, will remain ineligible for compensation, the rationale being that:
— "Public authorities have much better access to credit than citizens, so should not be eligible for protection."

Although these changes will probably not increase risk of any bank defaulting, they will definitely increase the loss given default. Losses from either a bail-in or an insolvency process will be larger than they would otherwise have been, since there will be fewer creditors among which to share the losses.

The impact of a bail-in depends on, the size of loss incurred by the bank, the amount of equity capital and junior bonds that can absorb losses first, and the proportion of insured deposits, covered bonds and other liabilities that are exempt from bail-in.

Taking these factors into account, the chart below produced by Arlingclose Ltd. shows how the bail in would be financed for various levels of loss incurred under a theoretical bank default. For example a bail in requirement of 7% of the value of Co-op Bank would result in an 80% haircut in the value of a local authority fixed deposit.

The chart also shows the level of losses incurred by RBS, Co-op and Anglo Irish banks in recent years.
In addition given that bail-in exempt assets are clearly defined within the banking reform directives, there is scope for this picture to deteriorate further from the County Council's point of view in the near future, as more of the bank's assets are held in exempt instruments so increasing the proportionate bail in risk to uninsurable deposits.
Although under the current circumstances further borrowing is unlikely, the Commissioner will continue to monitor the prevailing and forecast interest rate situation. Regular forecasts of interest rates are provided by Arlingclose Ltd, treasury management advisers to Lancashire County Council.

IMPACT OF A % LOSS OF RISK-WEIGHTED ASSETS ON UNSECURED UNINSURED CREDITORS AFTER JULY 2015

LOSS	Barclays	Close Bros	Clydesdale	Co-op Bank	HSBC Bank	Lloyds ex TSB	RBS Group	Santander UK	Stan Chart	Svenska Hand	TSB	Virgin Money
1%	E	E	E	E	E	E	E	E	E	E	E	E
2%	E	E	E	E	E	E	E	E	E	E	E	E
3%	E	E	E	E	E	E	E	E	E	E	E	E
4%	E	E	E	E	J	E	E	E	E	E	E	E
5%	J	E	E	E	J	E	J	E	E	E	E	E
6%	J	E	E	56%	H	J	J	J	J	E	E	E
7%	2%	E	E	80%	H	J	J	J	J	E	E	E
8%	5%	E	E	100%	H	J	J	J	J	E	E	E
9%	8%	H	J	100%	H	J	J	3%	J	E	E	E
10%	11%	H	J	100%	2%	J	J	6%	J	E	E	100%
11%	15%	4%	1%	100%	6%	J	7%	10%	H	E	E	100%
12%	18%	9%	11%	100%	11%	J	15%	14%	H	0%	E	100%
13%	21%	13%	22%	100%	15%	J	23%	18%	H	1%	E	100%
14%	24%	18%	32%	100%	20%	4%	32%	21%	H	2%	E	100%
15%	27%	23%	42%	100%	24%	10%	40%	25%	H	4%	E	100%
16%	30%	23%	53%	100%	29%	15%	48%	29%	0%	5%	E	100%
17%	33%	23%	63%	100%	33%	21%	57%	33%	6%	6%	E	100%
18%	36%	23%	74%	100%	38%	27%	63%	36%	6%	7%	E	100%
19%	39%	23%	84%	100%	42%	32%	63%	40%	6%	8%	J	100%
20%	41%	23%	86%	100%	47%	38%	63%	44%	6%	9%	J	100%

RBS 2008 ←----
Co-op 2013 ←----
Anglo Irish 2008/9 ←----

E - Loss is covered by equity
J - Loss is covered by a bail-in of junior debt
H - Loss is covered by a bail-in of holding company senior debt or conversion of loan from parent
% - Loss to be covered by a bail-in of senior unsecured debt and uninsured deposits
Balance sheet data as at June 2014 except Close Bros (July), Clydesdale (March), Svenska (September) and Virgin (December 2013)

Current Investments

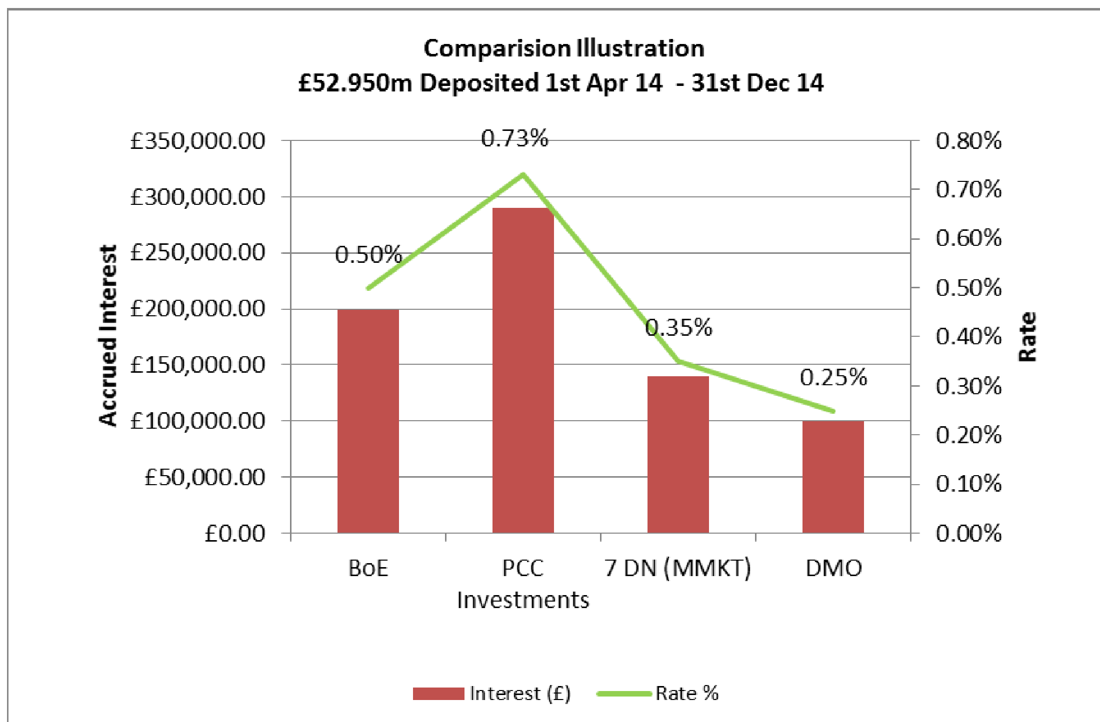
At 31st December 2014 the Commissioner held £50.23m invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Commissioner's investment balance has ranged between £76.99m and £13.67m, and similar levels are expected to be maintained in the forthcoming year.

In line with the 2014-15 treasury management strategy which continues the policy of credit risk reduction following the financial crisis, the Commissioner will only use very high quality counterparties for investments. All of the Commissioner's investments are currently with other local authorities

The Commissioner currently has access to a call (instant access) account, which currently pays 20 basis points (0.20%) above bank rate, this is currently 0.70%. Each working day the balance on the Commissioner's Current Account is invested in this to ensure that the interest received on surplus balances is maximised.
In addition a long term loan has been placed with another UK local authority as outlined below:

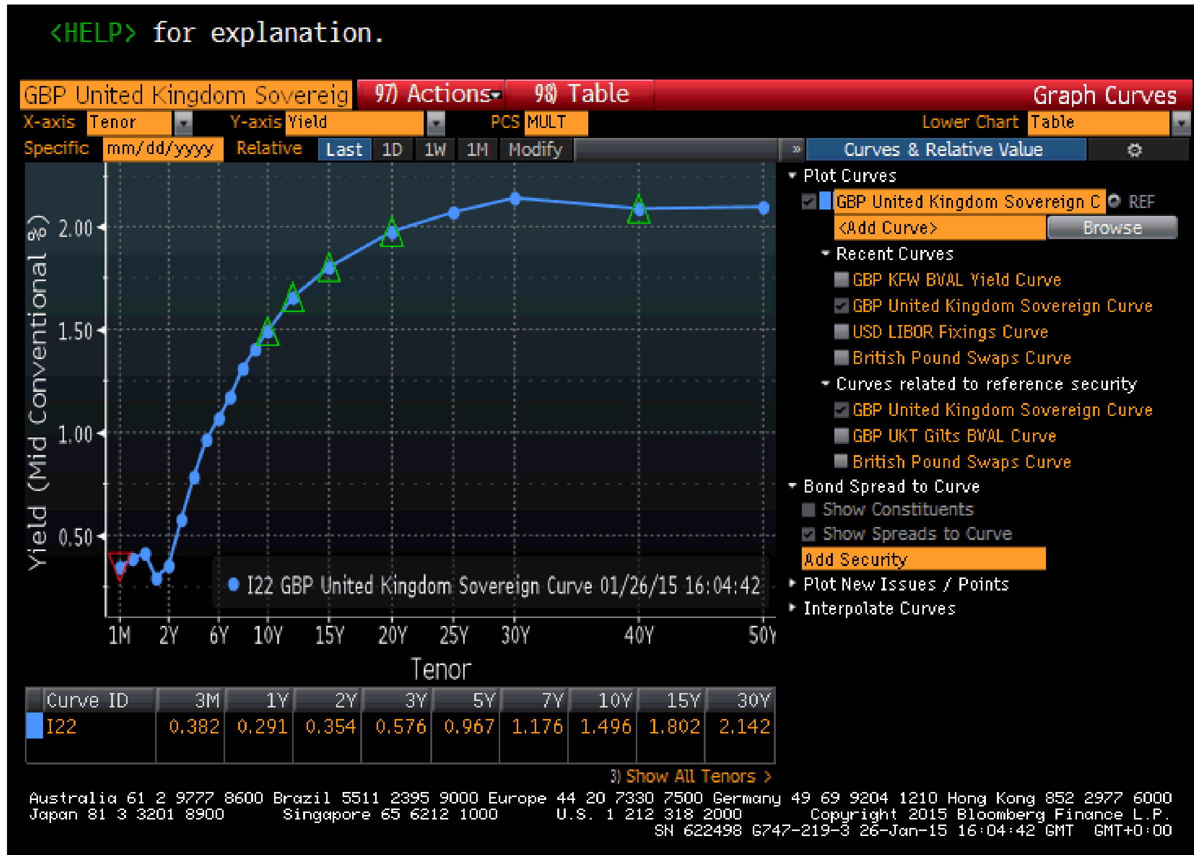
Start Date	End Date	Principal	Rate	Annual Interest	Interest 2014/15
22/10/14	23/10/17	£5,000,000	1.5%	£75,000	£32,877

The overall combined amount of interest earned on Fixed/Call balances as at 31st December 2014 is £288k on an average balance of £52.950m at an annualised rate of 0.73%. The current interest rate is 0.78%.This compares favourably with the benchmark 7 day LIBID which averages 0.43% over the same period, and is 0.23% above bank rate and 0.48% above the UK Government debt management office rate. These margins are illustrated in the chart below:



The low interest rate environment is also illustrated in the graph below which shows the UK Government (Gilt) yield curve on 26/1/15 showing the rate of return on gilts for various

maturities. For example the return on a gilt maturing two years from now is 0.354% and for a 5 year investment the rate is 0.967%.



Both the CIPFA Code and the CLG Guidance require the Commissioner to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Commissioner's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The Commissioner may invest surplus funds with any of the counterparties in the table below, subject to the cash and time limits shown.

<table>
<tr><th colspan="2">Counterparty</th><th>Cash limit</th><th>Time limit †</th></tr>
<tr><td rowspan="4">Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:</td><td>AAA</td><td rowspan="4">£5m each</td><td>5 years*</td></tr>
<tr><td>AA+</td><td>3 years*</td></tr>
<tr><td>AA</td><td>2 years*</td></tr>
<tr><td>AA-</td><td>2 years*</td></tr>
<tr><td colspan="2">Call Accounts with banks and other organisations with minimum AA- credit rating</td><td>£10m</td><td>next day</td></tr>
<tr><td colspan="2">UK Central Government (irrespective of credit rating)</td><td>unlimited</td><td>50 years**</td></tr>
<tr><td colspan="2">UK Local Authorities (irrespective of credit rating)</td><td>unlimited</td><td>50 years**</td></tr>
<tr><td colspan="2">Secured Bond Funds AA rating and WAL not more than 3 yrs</td><td>£5m each</td><td>n/a</td></tr>
<tr><td colspan="2">Secured Bond Funds AAA rated and WAL not more than 5 yrs</td><td>£5m each</td><td>n/a</td></tr>
</table>

* but no longer than 2 years in fixed-term deposits and other illiquid instruments
** but no longer than 5 years in fixed-term deposits and other illiquid instruments

From 1st April 2015, as part of the county council's budget strategy, the County Treasurer has reduced the rate of interest paid on call deposits to fall in line with current market rates to bank rate, currently 0.5%.

It is likely that in future the strategy will be to rely less on the call account and place deposits for a longer duration or use other secure investments from the table above to maintain current yields.

This strategy reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented as described above. Money market funds have also been removed from the 15/16 policy because they are subject to the new bank bail-in legislation and other regulatory uncertainties.

As a replacement liquidity option bond funds have been included within the treasury policy with allowable funds defined by credit rating and weighted average life (WAL.)
Investing in senior secured bonds backed by collateral provides a protection against bail-in. Although the average life of the securities within the fund will be either 3 or 5 years, funds can be redeemed within 2 days of request. The fund targets returns of 3 month Libor + 40 basis points which is currently around 0.96% in total.

The bond funds will provide exposure to the bond market without physically owning individual bonds. However a further option is to invest with the UK Government by buying government bonds and holding them to maturity. This type of investment is seen as risk free, but appropriately the yield on the investment is very low. In addition the investor has to be certain they can lock the funds away for the full term of the investment, otherwise there is an exposure to market risk, whereby the investment may need to be sold at a price which incurs a capital loss.

Whilst the investment strategy has been amended to allow greater flexibility with investments any decision as to whether to utilise this facility will be made based on an assessment of risk and reward undertaken jointly between the Chief Finance Officer and LCC Treasury Management Team, and consideration of this forms part of the on-going meetings that take place throughout the year.

The legislative and regulatory background to treasury management activities requires the Commissioner to set out the use of “specified” and “non-specified” investments.

Specified Investments: The CLG Guidance defines specified investments as those:-

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of “high credit quality”.

The Commissioner defines "high credit quality" organisations as those having a credit rating of A+ or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

Non-Specified Investments are any investment that does not meet the definition of a specified investment. The Commissioner does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition of specified credit quality.

The Commissioner may lend or invest money using any of the following instruments:-

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits where the Commissioner may demand repayment at any time (with or without notice),
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

On behalf of the Commissioner the county council's treasury management section prepares daily cash flow forecasts to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Commissioner's medium term financial plan and cash flow forecast.

The performance target on investments will remain as being above the average rate for 7 day notice money.

7. Minimum Revenue Provision (MRP) Strategy

The previous Lancashire Police Authority implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09 and this was subsequently adopted by the Commissioner. The Commissioner is required to assess MRP for 2015/16 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the Capital Financing Requirement method for MRP calculation. This option allows for the MRP to be calculated as 4% of the Capital Financing Requirement. The CFR is derived from the Balance Sheet and represent the value of the fixed assets, for which financing provision has not already been made. This method of calculation

has been used by the Authority since the introduction of the MRP in 2004. Unsupported borrowing reflected within the debt liability at 31st March 2010 will under delegated powers be subject to MRP under the Asset life method, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Commissioner. However, the Commissioner reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Commissioner are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

In summary it is proposed that the Commissioner continues to use the Capital Financing Requirement option as applied to all supported borrowing.

The Commissioner currently applies the Asset Life method (Equal Charge approach) to capital expenditure financed by unsupported borrowing and it is proposed that this option also be continued.

The capital programme contains a scheme for the replacement of Blackpool police station which will involve an additional MRP charge to cover the financing of the new asset. This charge will be deferred, using current capital financing regulations, until the asset becomes fully operational in 2018/19, when savings will be realised from the restructure of the existing facilities.

Prudential Indicators for 2013/14 to 2016/17 in respect of the Police and Crime Commissioner's Treasury Management Activities.

In accordance with its statutory duty and with the requirements of the Prudential Code for Capital Finance and the CIPFA Code for Treasury Management, every local authority produces each year a set of prudential indicators which regulate and control its treasury management activities.

The following table sets out the debt and investment-related indicators which provide the framework for the Commissioner’s proposed borrowing and lending activities over the coming three years. These indicators will also be approved by members as part of the Capital Programme approval process along with other capital expenditure-related indicators, but need to be reaffirmed and approved as part of this Treasury Management Strategy.

Treasury Management Prudential Indicators	2014/15 (Revised) £000	2015/16 £000	2016/17 £000	2017/18 £000
1. Adoption of the Revised CIPFA Code of Practice on Treasury Management	Adopted for all years in January 2012			
2. Authorised limit for external debt - A prudent estimate of external debt, which includes sufficient headroom for unusual cash movements.				
Borrowing	25,000	30,000	43,000	44,000
Other long-term liabilities	1,000	1,000	1,000	1,000
TOTAL	26,000	31,000	44,000	45,000
3. Operational boundary for external debt - A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Commissioner's current plans.				
Borrowing	22,000	27,000	40,000	41,000
Other long-term liabilities	1,000	1,000	1,000	1,000
TOTAL	23,000	28,000	41,000	42,000

4. Gross Debt / Capital Financing Requirement Indicator

	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m
Capital Financing Requirement	36.839	42.376	55.537	56.734
Maximum Gross Debt	18.879	24.416	37.577	38.774
Debt to CFR	51.25%	57.62%	67.66%	68.34%

This is a measure of prudence recently introduced into the code. The fact that gross debt is less than the capital financing requirement is taken as an indicator borrowing has only been made for capital purposes.

	2014/15	2015/16	2016/17	2017/18
5. Upper limit for fixed interest rate exposure				
Upper limit of borrowing at fixed rates	100%	100%	100%	100%
Upper limit of investments at fixed rates	100%	100%	100%	100%
6. Upper limit for variable rate exposure				
Upper limit of borrowing at variable rates	75%	75%	75%	75%
Upper limit of investments at variable rates	100%	100%	100%	100%
7. Upper limit for total principal sums invested for over 364 days (per maturity date as a percentage of total investments.**)**	75%	75%	75%	75%

8. Maturity structure of Debt	Upper Limit %	Lower Limit %
Under 12 months	50	-
12 months and within 24 months	50	-
24 months and within 5 years	50	-
5 years and within 10 years	80	-
10 years and above	90	25

Decision Required

The Commissioner is asked to approve the treasury management strategy for 2015/16, including

a) Treasury management prudential indicators

b) The borrowing strategy

c) The investment strategy

d) The MRP strategy

e) To formally adopt the updated policy statement at Appendix A

Appendix A

Treasury Management Policy Statement

The Police and Crime Commissioner's financial regulations require him to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of his treasury activities, as a cornerstone for effective treasury management.

Definition
The Police and Crime Commissioner defines his treasury management activities as: the management of the Commissioner's investments and cash flows, his banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Risk management
The Commissioner regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of his treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Value for money
The Commissioner acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. He is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy
The Commissioner greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. However, short-term and variable rate loans may be borrowed to either offset short-term and variable rate investments or to produce revenue savings. The Commissioner will also constantly evaluate debt restructuring opportunities of the existing portfolio,

The Commissioner will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. He will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

The Commissioner's primary objectives for the investment of his surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of services is an important, but secondary, objective.

The Commissioner will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.